

# ICPS newsletter

## Today's Budget of Ukraine Is Only a Guideline not a Law

*On June 16 the 1999 Open Budget for Ukraine was submitted for evaluation. The final publication of the Open Budget project implemented, by the Institute of Reforms, Ukrainian-European Policy and Legal Advice Centre, and ICPS, presents the results of their analysis of budget development strategy, and revenues and expenditures management*

Existing legislation does not promote realistic budgets

### *Budget resolution*

According to current legislation, draft budgets should be developed on the basis of the main directions of the budget policy (budget resolution) approved by the Verkhovna Rada. Ms. Inna Lunina, a project expert, believes that the budget resolution actually never indicates directions of budget policy, but that it is only a general document, regarding which every Verkhovna Rada deputy tries to lobby his own interests.

Thus, according to the resolution for 1999, government budget policy was obliged to meet two requirements that contradicted one another:

- to encourage overcoming the Ukrainian economic crisis;
- to ensure full expenditures for social programs developed on the grounds of current legislation, in particular, at the cost of doubling the budget deficit.

According to the Budget Policy Committee of the Verkhovna Rada in 1999 expenditures for social programs were about UAH 180 billion, or 45 percent more than the predicted GDP. All subsequent stages of preparing of the 1999 budget were directed to find possibilities of increasing revenues to finance state obligations, which were beyond budget strength. This circumstance is the main cause of the overstatement of planned indicators of state budget revenues. Thereby, during the development of the 1999 budget, the budget resolution actually complicated the process of budget development and adoption, as it was oriented on needs but not on actual institutional conditions and state financial capacities.

### *Rules of Procedure for the Verkhovna Rada*

Analysis of the provisions of the *Rules of Procedure for the Verkhovna Rada* shows that there are at least four disadvantages of

current legislative principles of the budget process in Ukraine:

1. **Rules of Procedure permit development of draft budgets without a formulated legislative base**, and leads to the overstatement of planned revenues. The *Rules* permit amendments to legislation (including on taxation) in the second half of October of the current year, if Verkhovna Rada deputies or committees manage to approve appropriate amendments in the draft budget. Moreover, the document prohibits making any changes in the taxation system till the adoption of the budget resolution for the next year.
2. **Legislative power was granted extensive rights to make changes in the budget revenue indicator** proposed by the Ministry of Finance. Revenues may be adjusted on the basis of proposals of Verkhovna Rada deputies at the Budget Committee meeting. Efforts of deputies to increase expenditures at any price leads to a rise of the planned revenues indicator, without sufficient grounds.
3. **Maximum size of the deficit is determined and approved not before budget expenditures planning, but during second reading**, and only then proposals for deficit reduction are examined.
4. Adoption of the State Budget is considered timely on any day before January 1 of the budget year, thus **local budgets can not be prepared and adopted in proper time**, i.e., also before January 1.

### Chronic shortfall of budget revenues

In 1996, only 87 percent of planned revenues were received by the Consolidated Budget, with 92.4 percent in 1997 and 95.6 percent in 1998 (including 75.3 percent to the State Budget). Many factors affect the shortfall of budget revenues. According to Ms. Oksana Remiga, these factors may be divided into the following groups:

- miscalculations at the stage of planning, examination and adoption of the budget (in particular, constant overestimation of

### **Last week**

**Lessons of the Country Economic Memorandum project.** On June 15 the ICPS macroeconomic seminar was devoted to a discussion of obstacles which arose during the Country Economic Memorandum work. The speakers were Dusan Vujovic, program team leader on the World Bank side, and Serhij Loboyko, project coordinator on the ICPS side.

Mr. Vujovic noted that differing viewpoints of foreign and Ukrainian experts grew out of ideological bias, different work principles, insufficient application of research experience of other countries, and lack of planned joint work.

To avoid such divergence in the future, an institutional capacity for strong economic policy should be built. This capacity includes the employment of qualified experts for policy analysis; introduction of organisational procedures able to provide extensive support for reform policies; and existence of an institutional ability to manage change. Ukrainian civil servants should also build their individual capacity, providing for such features as excellent professional qualifications, policy analysis and technical skills, readiness to debate with foreign experts and present their own alternative strategies.

Positive project outcomes have already been noted. Serhij Loboyko emphasised the following:

- experience in policy analysis focusing on the causes of problems, not only their negative effects;
- experience in policy analysis focusing on alternatives and comparative evaluation of their outcomes;
- procedural collaboration of foreign experts with Ukrainian government during the process of policy analysis.

### **This Week**

**Education development strategies in Lviv.** The problems of education in

the regions and in Lviv will be discussed at a seminar held on June 22-23 in Lviv. Seminar organisers are the Lviv municipal and oblast radas and ICPS. Participants will discuss the following questions:

- Why is the transformation of education necessary?
- The role of local communities in the transformation of education.
- Specificity of regional educational policy.
- Technical tasks of the working group in developing and applying regional educational policy.

### **Next Week**

**Target levels for government revenues in GDP.** Please note that the ICPS macroeconomic seminar on "Target levels for government revenues in GDP" planned for June 22 will be held on June 29. Presentations will be given by Apostolos Papaphilippou and Alexei Sekarev, economic advisors to the Ukrainian-European Policy and Legal Advice Centre.

*Concerning invitations for ICPS seminars, please contact Larysa Romanenko.*

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GDP predicted by the government);

- deepening economic recession and, as a result, narrowing revenue base for the budgets;
- increase of nonpayments to the budget;
- unbalanced taxation system, with high rates and at the same time with a generous system of privileges;
- ineffective system of managing budget revenues.

The increase of nonpayments to the budget testifies the inadequacies of fiscal policy and appears as a response of the economy to the following circumstances:

- heavy taxation pressure;
- lack of a real threat of bankruptcy for debtor enterprises;
- possibility for writing-off and restructuring tax indebtedness.

Nonpayment to the budgets has become a form of cost compensation for many unprofitable enterprises. In writing off the tax debts of these enterprises, the state, as a matter of fact, is applying indirect methods of subsidization.

### **Unreality of the budget has destructive consequences**

According to Ms. Tetiana Vakhnenko, the lack of real measures of budget reform,

the reduction of state obligations, and the problems of budget revenues has led to the increase of loan debts of the budget sector and to the transformation of the deficit into a form that hides these debts.

Through unrealistic budgets and unclear adjustment mechanism, lawfully approved expenditures, and estimates, are chronically underfinanced. The absence of effective control and responsibility creates the possibility to exceed financing on some items and articles. The budget of Ukraine operates under conditions of manual control: its main spending units receive means on daily basis from those received by the State Budget account, on the decision of the Prime Minister, Minister of Finance and Chief of the Head Office of the State Treasury. Spasmodic expenditures reduction at the stage of budget execution intensifies the budget crisis. Sequestration prevents the realisation of priority directions of state policy and complicates for the process of efficient long-term planning.

At the same time, budget execution should have purely mechanical character: adopted lawful assignments should be brought to the notice of the main spending units, and, in the case of revenue deficiency, the financing volume is adjusted through the procedure of revising the law on the state budget.

## **Coordination and Analysis Center Lobbies Business Interests**

***The Coordination and Analysis Center of the Ukrainian Business Association was established on December 7, 1998. Its founders and members are 14 organizations, including International Centre for Policy Studies. Participants have agreed to combine their efforts of analytical work in the fields of monitoring, expertise and support of draft laws of Ukraine relevant to entrepreneurial activity. The results of six months' existence were summed up at an open meeting of the Board of the Center on June 18, 1999***

Since its foundation the Coordination and Analysis Center submitted more than 70 analytical materials connected with draft laws on economic and social topics to the Verkhovna Rada. Its *campaign to revoke the stamp duty* was particularly successful; in consequence the Verkhovna Rada adopted a law annulling stamp duties on internal transactions. This action has become an excellent example of the ability of business associations to assert the rights and interests of their members.

To define the most critical problems of businesses, the Coordination and Analysis Center held a number of focus groups and round tables. Based on the outcomes, activity

was focused on the following directions:

1. *Application of standard accounting forms for primary accounting documents.* As a result, the State Committee for Business Development made a decision to suspend the Order of the State Statistics Committee dated June 27, 1998.
2. *Mandatory certification of automobile transport services:* analytical surveys were conducted, and a proposal was submitted to SCBD to suspend this provision of the State Statistic Committee dated March 19, 1999.
3. *Minimal size of authorised funds for limited partnerships:* on May 5, 1999 the Verkhovna Rada endorsed the Law decreasing

the size of authorised funds for limited partnerships from 625 to 100 minimum [monthly] wages.

4. *Simplified taxation and accounting for small businesses:* analytical materials were submitted to the Verkhovna Rada, and amendments for the draft law were developed.

5. *Electronic accounting reports to be submitted to the State Tax Administration:* the SCBD adopted this decision dated March 3, 1999 with further submission of materials to the Anti-Monopoly Committee of Ukraine.

6. *Forcing commercial banks to conduct fiscal activities:* an open letter was published and an appeal by Verkhovna Rada deputies was sent.

The Board of the Coordination and Analysis Center decided to start a new campaign for the introduction of special trade licenses throughout Ukraine. It was also agreed to focus efforts on the draft Tax Code and solutions to problems of private pension funds.

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